independent appraisal regarding the value of the equipment was undertaken in 2003 using both the actual appraisal date, March 1999, and July 1, 1999, the date suggested by the SLD. The Appraisal Report valued Riverside's equipment at $1,859,321 in March 1999 and $1,316,159 as of July 1, 1999.[8] The Appraisal Report, which USAC and the SLD accepted as dispositive of the July 1, 1999 valuation, concluded that Spectrum's valuation of the equipment as of March 1999, was entirely consistent with the then-current market.

In valuing the trade-in equipment in 1999, Riverside and Spectrum complied with all Program rules that were effective at that time (*i.e.*, they assessed the appropriate fair market value of the equipment, and they did not trade in equipment that was previously purchased with Program funds). In the absence of specific guidance on when the trade-in equipment should be valued, the parties observed the basic legal principle that essential contract terms, including the consideration for a contract (*i.e.*, the trade-in equipment) must be definite and certain at the time of contract formation. The SLD's and USAC's actions in imposing a new date of valuation, based upon retroactive application of new Program rules, rewrites the essential terms of the agreement (*i.e.*, offer, acceptance and consideration) without the assent of the parties.

C. Commission and SLD Guidance in 1999.

At the time Riverside filed its Form 470 and entered into a contract with Spectrum in 1999, very little guidance was available to participants in the E-rate Program regarding the FCC's and SLD's policy for trading in equipment. Even now, the guidance does not specifically address *when* the fair market value of traded-in equipment should be determined in all cases. Rather, it only addresses fair market value in the case of the SLD's 3-year depreciation value analysis discussed below.

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[8] *See* Appraisal Report.

Today, the SLD's website has a page devoted to trading in equipment. That page advises that a Program applicant can trade in equipment and apply the value of that equipment to the non-discounted portion of new products and services that are funded through the E-rate Program.[9] The SLD places certain conditions, however, on trading in equipment: (1) equipment previously purchased with E-rate discounts cannot be used toward payment of an applicant's non-discount share; and (2) the amount credited toward the non-discounted share must be the fair market value or acquisition cost, which ever is lower.[10] The foregoing Program rules were applicable in 1999 when Spectrum and Riverside entered into their agreement for E-rate services. However, with regard to determining fair market value, the Program rules now also state the following:

> There is a rebuttable presumption that technology equipment has a three-year life and that the value declines on a straight-line basis. Therefore, the presumptive value of a component with an original cost of $1000 would be $666 after one year, $333 after two years, and would have no value after three years. Time periods are calculated from the date that equipment was originally delivered to the applicant to the estimated delivery date to the service provider. The applicant or service provider may provide evidence of fair market value to rebut this presumption. Although the form of the evidence is flexible, the best evidence would be from an independent third party source indicating the secondary market prices for the specific make and model of equipment traded in.[11]

As an initial matter, the Program rules regarding timing of valuations and depreciation methodology were not available in 1999. The SLD's guidance at that time was more general, stating only that equipment must be traded-in at its fair market value and that the equipment to be traded could not be equipment previously purchased with Program funds. As discussed

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[9] Universal Service Administrative Company, "Transfer or Trade-in of Components," available at http://www.sl.universalservice.org/reference/epsfaq-f.asp (last modified Feb. 13, 2004).

[10] *See id.*

[11] *Id.*

above, Spectrum and Riverside fully complied with these requirements. Spectrum carefully evaluated Riverside's equipment, which had not been previously purchased with Program funds, at the time they formed their agreement and calculated the fair market value of the equipment based upon Spectrum's considerable expertise in the market. Although the Program rules now explain how and when to assess the fair market value of equipment under the SLD's presumptive 3-year depreciation value analysis, it is devoid of any explanation regarding how or when Program participants should assess the fair market value of equipment using any other analysis. It does not appear that the new Program rule requires, as USAC contends in the *Administrator's Decision on Appeal,* that all valuations for trade-in equipment must be based on the date the service provider takes possession of the equipment, or no earlier than the first day of the funding year. Rather, it appears the new Program rule prescribes the dates to be used for valuing equipment when parties use the 3-year depreciation analysis. Spectrum did not use a 3-year depreciation analysis in the case of Riverside, and thus the new rule is inapplicable. In addition, the new Program rule allows for independent third party appraisals to rebut the SLD's presumptive 3-year depreciation value analysis, which Spectrum provided in this case.

Most importantly in this case, with the exception of requirements for a fair market valuation and a prohibition against trading-in "Program" equipment which Spectrum and Riverside observed, none of the foregoing guidance about the date upon which trade-in equipment should be valued, or valuation methodologies, was available to Spectrum or Riverside in 1999 when Spectrum assessed the fair market value of Riverside's equipment, Spectrum bid for Riverside's E-rate services, Riverside accepted Spectrum's bid, the parties entered into an agreement for services and agreed upon the consideration, the SLD approved Riverside's funding requests, and valuable E-rate services were provided in reliance thereon. Spectrum was

notified of the SLD's new policy only after Mr. Falkowitz from the SLD contacted Spectrum in March 2003.[12] The email correspondence between Mr. Falkowitz and Spectrum, indicates that the only "guidance" the SLD received from the FCC on this issue was that the fair market value of traded-in equipment could be calculated using the rebuttable presumption that equipment has a useful life of three years.[13] It does not appear the FCC addressed the date upon which the fair market value should be determined.

III. QUESTIONS PRESENTED FOR REVIEW.

A. What Was the Required Valuation Date for Equipment that Was Traded-In Through the E-Rate Program in 1999?

Today, the SLD and USAC claim that equipment that is traded in for the purpose of paying an applicant's non-discounted portion of services purchased through the E-rate Program must be valued either at the time the service provider takes possession of the equipment or the first day of the applicable Program funding year. This guidance was not available to Riverside and Spectrum in 1999 and should not be applied retroactively to either devalue services that were already provided in reliance on the former rules and SLD funding grants, or require additional cash consideration from Riverside which it did not agree to pay for E-rate services in 1999. In the absence of specific guidance from the FCC or the SLD, the parties followed basic, well-established principles of contract law when they entered into their agreement for E-rate services and assessed a fair market value for Riverside's traded-in equipment at the time of contract formation. This valuation was later substantiated by an independent third party appraisal. It is also important to note that Riverside and Spectrum were required to assess the fair market value

[12] *See* email from Ed Falkowitz, Accounting Manager, SLD, to John Price, then-present Chief Financial Officer of Spectrum (Mar. 3, 2003), attached as Exhibit 4 hereto.

[13] *See id.*

of the trade-in equipment and agree upon the consideration at the time of contract formation in order to obtain necessary board approvals and meet applicable SLD filing deadlines.

"Under long-standing principles of contract law, three familiar elements are typically required for the formation of a contract: offer, acceptance, and consideration."[14] Consideration is an essential element of a valid contract,[15] and a contract is not enforceable unless its terms and conditions are definite and certain.[16] In the absence of specific FCC or USAC guidance regarding the timing of valuations for trade-in equipment, Spectrum and Riverside used basic principles of contract law and, at the time of contract formation – not an undefined later date – assigned a fair market value to the trade-in equipment that would be used in lieu of cash. Without an upfront understanding by Riverside and Spectrum of the combination of consideration that would be paid for the E-rate services, and the corresponding payment obligations, the contract would have lacked definite and enforceable terms.

In response to Riverside's Form 470, Spectrum submitted a proposal that would meet the technology plan objectives of the consortium while, at the same time, avoid a significant cash outlay. Riverside reviewed the proposal and found it to be the most cost-effective response to its Form 470. Before agreeing to hire Spectrum, however, Riverside and/or its consortium members were required to obtain school board approval of the proposed contract. It would have been impossible for Riverside and its member districts to have obtained board approval without first

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[14] "Government Contract Cases in the United States Court of Appeals for the Federal Circuit: 1996 in Review," C. Stanley Dees and David A. Churchill, 46 Am. U.L. Rev. 1807, 1844 (Aug. 1997) (citing the Restatement (Second) of Contracts, §§ 17(1), 22(1)).

[15] *See, e.g., Agosta v. Astor*, 120 Cal. App. 4th 596, 605 (2004); *Lopez v. Charles Schwab & Co., Inc.*, 118 Cal. App. 4th 1224, 1230 (2004).

[16] *See, e.g., Suffield Development Associates Ltd. Partnership v. Society for Sav.*, 708 A.2d 1361 (1998).

describing in detail the purchase price and the terms (including the amount of cash required) of the agreement, and the E-rate services that would be received in exchange. Consequently, the parties had to value the equipment at the time they reached an agreement.

E-rate Program rules require applicants and service providers to enter into agreements for E-rate services before filing a Form 471.[17] Applicants use the Form 471 to request discounts from the SLD for eligible services, and specific amounts for the cost of the purchased services must be recorded in the Form 471. The agreement necessarily establishes the type and amount of consideration an applicant must pay for the goods and services purchased from a service provider so the applicant can seek the appropriate amount of E-rate support. It would have been impossible in this case for Riverside and Spectrum to predict the value of the equipment at some future date and still comply with USAC's requirement that the agreement be executed and the Form 471 filed by April 6, 1999. If Riverside and Spectrum had waited until the start of the funding year (July 1, 1999) to value the equipment, Riverside would have had to wait to enter into a contract with Spectrum and would have missed the deadline for filing its Form 471.

B. Did the Administrator Exceed its Authority by Creating New Policy and then Applying that Policy Retroactively to Spectrum?

1. The Administrator Exceeded its Authority in Adopting a New Policy Without FCC Guidance.

The FCC appointed USAC to administer the E-rate Program in 1998. USAC's authority over the Program is limited to implementing and applying the FCC's Part 54 rules, and the FCC's interpretations of those rules as found in agency adjudications.[18] USAC is not

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[17] Universal Service Administrative Company, Selecting Service Providers, available at: http://www.sl.universalservice.org/reference/selectingsp.asp.

[18] 47 C.F.R. § 54.702(c).

empowered to make policy, interpret any unclear rule promulgated by the FCC[19] or to create the equivalent of new guidelines.[20] The Administrator exceeded its authority in this case by creating a new policy not previously elucidated by the FCC – namely, that the fair market value of traded-in equipment cannot be calculated at the time that an E-rate applicant and service provider execute a contract for E-rate services and products, consistent with basic principles of contract law.

In 1999 when Spectrum and Riverside entered into their agreement, there was no FCC or Program guidance that addressed *when* the fair market value of traded-in equipment should be determined, and such formal guidance still does not exist today (except in the case of equipment that is valued using a 3-year depreciation analysis). Spectrum only became aware of the new SLD Program rule in March 2003 when Mr. Falkowitz contacted Spectrum about the trade-in value of Riverside's equipment.[21] As noted above, however, it does not appear that the FCC gave the SLD specific guidance regarding the date upon which the fair market value should be determined. Rather, the email correspondence between Mr. Falkowitz and Spectrum, indicates that the only "guidance" the SLD received from the FCC on this issue was that the fair market value of traded-in equipment could be calculated using the rebuttable presumption that equipment has a useful life of three years.[22] It appears USAC has made a policy and created the

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[19] *Id.*

[20] *Changes to the Board of Directors of the Nat'l Exchange Carrier Ass'n, Inc.*, Third Report and Order, 13 FCC Rcd 25058, 25066-67 (1998) ("*NECA Third Report and Order*").

[21] *See* email from Ed Falkowitz, Accounting Manager, SLD, to John Price, then-present Chief Financial Officer of Spectrum (Mar. 3, 2003), attached as Exhibit 4 hereto.

[22] *See id.*

equivalent of new guidelines regarding the timing of valuations for all traded-in equipment in violation of its charter.

2. The Administrator Exceeded its Authority in Retroactively Applying a Later-Adopted SLD Policy to Previously Granted Funding Requests.

Even assuming, *arguendo*, that the Administrator had authority to adopt the policy that the fair market value of traded-in equipment cannot be determined at the time a contract is executed, the Administrator still exceeded its authority by retroactively applying the policy in this case. In this case, the Administrator is attempting to apply a new Program rule regarding the timing for valuation of trade-in equipment to a contract for E-rate services that was entered into in 1999, and performed in 1999-2000, three years before adoption of the new Program rule.

It is a basic tenet of American jurisprudence that if a court overturns its prior precedent in a line of cases, the new precedent is applied prospectively. The court does not re-open every prior case, retroactively apply the new precedent and overturn all prior concluded decisions.[23] In *RKO General v. FCC*,[24] the U.S. Court of Appeals for the D.C. Circuit addressed retroactive application of new Commission precedent very clearly:

> Although an administrative agency is not bound to rigid adherence to its precedents, it is equally essential that when it decides to reverse its course, it must give notice that the standard is being changed . . . and apply the changed standard only to those actions taken by parties after the new standard has been proclaimed as in effect.[25]

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[23] *See generally* 28 U.S.C. § 2106 ("The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review.")

[24] *RKO General, Inc. v. FCC*, 670 F.2d 215 (D.C. Cir. 1981).

[25] *Id.* at 223-24, *citing Boston Edison Co. v. PFC*, 557 F.2d 845(D.C. Cir. 1997) *cert. denied sub nom. Towns of Norwood, Concord and Wellesley, Mass. V. Boston Edison Co.*, 434 U.S. 956 (1988).

In addition, "an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy."[26]

The SLD's standard regarding when to evaluate the fair market value of traded-in equipment was expressed to Spectrum only in March 2003 through general correspondence. This standard has not, and even today is not, explicitly stated in any FCC decision or on the SLD's website as a Program rule (except in the case of equipment that is valued using a 3-year depreciation analysis). Even if the FCC finds such a rule is now applicable, consistent with the finding in *RKO*, new or changed standards can be applied prospectively only to pending or future applications, not retroactively to granted applications.

In addition, Spectrum and Riverside detrimentally relied on the FCC and SLD guidance that was available in 1999, and it detrimentally relied on the SLD's grant of Riverside's funding requests under the former rules pursuant to which valuable E-rate services were provided and accepted. It is unreasonable for a Program participant, exercising good faith and complying with all applicable Program rules and general principles of contract law, to be penalized for acting reasonably under the circumstances, especially when there was no contrary FCC or USAC guidance specifying the date on which the fair market value of traded-in equipment should be assessed. Riverside and Spectrum had no other recourse but to reasonably assume the equipment should be valued at the time the agreement was formed.

There is an extensive body of judicial case law regarding impermissible retroactivity in which the courts discuss basic notions of equity and fairness and detrimental reliance by citizens

[26] *New England Telephone and Telegraph Co. v. FCC*, 826 F. 2d 1101, 1110 (D.C. Cir. 1987) *citing RKO General*, 670 F.2d at 223.

on prior agency policies.[27] There is no need to present a full discussion of such retroactivity here, as the FCC's own decisions in prior SLD matters reflect its own concern about the retroactive application of new precedent.

In a November 5, 1999 FCC decision involving the E-rate Program, the Commission considered a case in which the Prairie City School District ("Prairie City") sought review of an

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[27] *See Bowen v. Georgetown University Hospital*, 488 U.S. 204, 224 (1988) (J. Scalia concurring) ("[W]here legal consequences hinge upon the interpretation of statutory requirements, and where no preexisting interpretive rule construing those requirements is in effect, nothing prevents the agency from acting retroactively through adjudication."). *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 293-294 (1974); *SEC v. Chenery Corp.*, 332 U.S. at 194, 202-03 (1947). *See also Verizon Telephone Co. v. FCC*, 269 F.3d 1098 (2001) ("[T]he governing principle is that when there is a 'substitution of new law for old law that was reasonably clear,' the new rule may justifiably be given prospectively-only effect in order to 'protect the settled expectations of those who had relied on the preexisting rule."); *Id.* at 1109, *citing Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993)). Moreover, retroactivity will be denied "when to apply the new rule to past conduct or to prior events would work a manifest injustice." *Id. citing Clark-Cowlitz Joint operating Agency v. FERC*, 826 F.2d 1074, 1081(D.C. Cir. 1987). To determine whether a manifest injustice will result from the retroactive application of a statute, a court must balance the disappointment of private expectations caused by retroactive application against the public interest in enforcement of the statute. *Demars v. First Serv. Bank for Sav.*, 907 F. 2d 1237, 1240 (1st Cir. 1990) (*citing New England Power v. United States*, 693 F. 2d 239, 245 (1st Cir. 1982)). The D.C. Circuit Court notes that it has not been entirely consistent in enunciating standards to determine when to deny retroactive effect in cases involving "new application of existing law, clarifications and additions" resulting from adjudicatory actions. In *Cassell v. FCC*, the court acknowledges that it has used the five-factor test set forth in *Clark-Cowlitz* as the "framework for evaluating retroactive application of rules announced in agency adjudications." *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) *citing Clark-Cowlitz*, 826 F.2d at 1081. In a subsequent case, the court substituted a similar three-factor test. *See Dist. Lodge 64 v. NLRB*, 949 F.2d 441, 447 (D.C. Cir. 1991) (*citing Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971)). Today, the court has moved from multi-pronged balancing tests for impermissible retroactivity in favor of applying basic notions of equity and fairness. *See Cassell*, 154 F.3d at 486 (declining to "plow laboriously" through the *Clark-Cowlitz* factors, which "boil down to a question of concerns grounded in notions of equity and fairness"); *PSCC v. FERC*, 91 F. 3d 1478, 1490 (concluding that "the apparent lack of detrimental reliance . . . is the crucial point [supporting retroactivity]"). In *Chadmoore Communications, Inc. v. FCC*, the court stated that the test it commonly uses to determine whether a rule has retroactive effect is if "it does not impair [ ] rights a party possessed when it acted, increase [ ] a party's liability for past conduct, or impose [ ] new duties with respect to transactions already completed." *Chadmoore*, 113 F.2d 235, 240 (D.C. Cir. 1997), *citing DIRECTV, Inc. v. FCC*, 110 F. 3d 816, 825-26 (D.C. Cir. 1997) (*quoting Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994)).

SLD denial of its application for universal service support.[28] Prairie City argued that the SLD's denial should be overturned because Prairie City filed its application in reliance on filing guidelines provided by the SLD on its website. The FCC agreed with Prairie City and directed the SLD to issue a new funding commitment decision letter. Citing *Williamsburg-James City*, the FCC found that where an application was submitted before the establishment of a particular and applicable rule, the applicants could not have been aware of the application requirements.[29]

The FCC also has recognized that clarifications of its universal service policies are to be applied prospectively only by the SLD. In *Ysleta*[30] and *Winston-Salem*[31] the FCC clarified that a party submitting a bona fide service request under the E-rate Program must provide a Form 470 that lists the specific services for which the applicant anticipates seeking E-rate discounts, rather than a Form 470 that listed every service or product eligible for discounts.[32] The FCC, however,

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[28] *Request for Review of the Decision of the Universal Service Administrator by Prairie City School District*, 15 FCC Rcd 21826 (CCB 1999).

[29] *Id.* at 21827, citing *Request for Review of the Decision of the Universal Service Administrator by Williamsburg-James City Public Schools*, 14 FCC Rcd 20152, 20154-55 (1999) ("Williamsburg could not have been aware of the rules of priority at the time it filed its application." Williamsburg's application was also remanded for reprocessing and issuance of a new funding commitment decision letter. The applicant submitted its application in April of 1998 and new rules were adopted by the Commission in June of 1998.).

[30] *Request for Review of the Decision of the Universal Service Administrator by Ysleta Independent School District, El Paso, Texas*, 18 FCC Rcd 26406 (2003) ("*Ysleta*"). In *Ysleta* the Commission addressed multiple requests to review the decisions of the SLD that were filed by E-rate applicants, but combined the requests as they had almost identical fact patterns.

[31] *Request for Review of the Decision of the Universal Service Administrator by Winston-Salem/Forsyth County School District, Winston-Salem, North Carolina*, 18 FCC Rcd 26457 (2003) ("*Winston-Salem*").

[32] *Ysleta*, 18 FCC Rcd at 26419-23; *Winston-Salem*, 18 FCC Rcd at 26462.

did not invalidate the applicants' applications based upon this error.[33] It acknowledged that the SLD had previously granted similar funding requests and that Program participants could have reasonably relied on those approvals.[34] The FCC determined that such all-inclusive Form 470s "should not be permitted on a going-forward basis."[35] The FCC therefore "clarif[ied] prospectively that requests for service on the FCC Form 470 that list all services eligible for funding under the E-rate Program do not comply with the statutory mandate."[36] The FCC in *Ysleta* also provided additional guidance regarding other aspects of the E-rate Program rules "to provide greater clarity to *those applicants re-bidding services and future applicants.*"[37]

It is clear that the FCC intended for its precedent in *Ysleta* and *Winston-Salem* to apply to pending or future applications and not applications that have already been granted and funded. Similarly, the FCC should conclude that the SLD cannot retroactively apply the Administrator's new Program rule regarding the timing of valuing traded-in equipment to Spectrum's case. Riverside's funding requests were approved long before the SLD notified Spectrum of its new

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[33] The Commission did conclude in *Ysleta* that the applicants violated the E-rate Program's rules, although not because of the broad list of services included in the applicants' Form 470s. *Ysleta*, 18 FCC Rcd at 26420-21.

[34] *Ysleta*, 18 FCC Rcd at 26422; *see also Winston-Salem*, 18 FCC Rcd at 26462.

[35] *Ysleta*, 18 FCC Rcd at 26422; *see also Winston-Salem*, 18 FCC Rcd at 26462.

[36] *Ysleta*, 18 FCC Rcd at 26422-23 (citation omitted); *see also Winston-Salem*, 18 FCC Rcd at 26462.

[37] *Ysleta*, 18 FCC Rcd at 26433-34 (emphasis added). The Commission also noted that the "SLD will carefully scrutinize *applications*" to ensure that they comply with the clarifications elucidated in this case. *Id.* at 26435 (emphasis added). If the Commission wanted the SLD to apply those clarifications retroactively to prior SLD decisions, it would have specifically directed the SLD to do so. The FCC also rejected the argument that it could not apply the E-rate Program rules to the applicants' pending funding requests in a adjudicatory context. According to the FCC, "[t]he fact that in prior years, [the SLD] did not disapprove applications that utilized the procurement processes at issue in no way limits our discretion to apply our *existing rules*." *Id.* at 26433 (emphasis added).

Program rule. Furthermore, the FCC has never determined that the fair market value of traded-in equipment cannot be established at the time a contract is formed. Spectrum and Riverside (and possibly other E-rate participants) relied on the FCC and SLD rules, and interpretations thereof, which were current in 1999, and reasonably interpreted them to support their valuation of the traded-in equipment at the time of contract formation. The rules in 1999 required a fair market valuation for Riverside's equipment and, as the independent third party appraisal confirms, Spectrum assessed a fair market value for the Riverside equipment.

The FCC also must consider the long term impact on the E-Rate Program if it does not reverse the Administrator's decision in this case. Specifically, it will raise serious questions for other participants in the E-rate Program about whether they can ever rely upon actions taken by the SLD. Allowing the Administrator's decision to stand would mean that the SLD and the Administrator can adopt new policies at will and retroactively deny previously granted applications based upon those new policies after the applications are approved. In the face of such regulatory uncertainty, service providers could certainly conclude that the risk of devoting resources to provide E-rate services is too great. Schools, libraries, students and faculty would be those that ultimately suffer.

3. The Administrator has Advocated Applying Only Program Rules Relevant to a Particular Funding Year to Its Own Audits.

The concept of the SLD applying E-rate Program rules that were in effect only for a particular funding year to judge compliance with its program is something USAC, itself, has advocated for its own audits of E-rate Program compliance. In USAC's November 26, 2003 report to the Commission entitled "*Task Force on the Prevention of Waste, Fraud and Abuse,*" the Task Force recommends that it develop audit policies that:

> reflect compliance with the rules that existed during the funding year to which the funding was associated and to better communicate the degree of

> program compliance . . . The Task Force believes that program audits, which are a necessary part of waste, fraud and abuse prevention, need to focus on the policies, procedures, eligible services, etc., that existed during the funding year that is being audited. Measuring program compliance against policies, procedures, eligible services, etc. which were not in place during a particular funding year is inherently unfair and invalid.[38]

This approach should apply equally to participants in the E-rate Program like Riverside and Spectrum. The SLD's new policy regarding when traded-in equipment should be valued, should not be used as the filter through which Spectrum's and Riverside's 1999 agreement is judged. Spectrum and Riverside complied with all Program rules applicable to trade-in equipment that were effective in 1999.

C. If the FCC Concludes that E-Rate Funds Were Erroneously Disbursed, Should the SLD Seek Reimbursement from Riverside or Spectrum?

Assuming *arguendo* that the proper valuation date for Riverside's traded-in equipment was July 1, 1999, then Riverside would not have paid its entire non-discounted portion of the E-rate funded services it obtained from Spectrum. Accordingly, if the FCC should conclude that E-rate funds were, in fact, erroneously disbursed in this case as a result of the use of an incorrect

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[38] *Recommendations of the Task Force on the Prevention of Waste, Fraud and Abuse*, CC Docket No. 02-6 at 10 (Nov. 26, 2003). The Task Force also makes a number of other recommendations to improve the schools and libraries program, concluding that "the program's competitive bidding process is not working as effectively as policy makers had intended." *Id.* at 5. "The Task Force believes there needs to be greater clarification of program rules, along with increased strong program support staff and educational outreach to further ensure optimal usage of program resources." *Id.* "Prior to the start of the annual training cycle, the SLD needs to provide clear policy, procedures, eligible services list, etc. for the upcoming program year and work to minimize the need for clarifications of the rules during the Program Integrity Assurance review process." *Id.* at 6. "The Task Force believes that if applicants have a better understanding of the rules and standards that will be applied, they will be better equipped to obey them. Providing clarity at the beginning of the cycle will also help avoid the waste associated with pursuing appeals that result from a misunderstanding of the rules." *Id.*

valuation date, the FCC should conclude that Riverside is responsible for any unpaid monies that are the result of it not paying the non-discounted portion of the E-rate services it purchased.[39]

The *Administrator's Decision on Appeal* notes that the FCC requires all erroneous disbursements to be collected from service providers.[40] However, the Commission instructs USAC to recover such funds from "whichever party or parties has committed the statutory rule or violation."[41] The duty to pay the undiscounted portion is solely Riverside's responsibility.[42] In fact, USAC rules expressly prohibit the service provider from taking any action that would eliminate or lessen the applicant's obligation to pay the entire undiscounted portion. Consequently, any failure to pay the undiscounted portion would constitute a Program violation by Riverside, the beneficiary of the E-rate services.

D. If the FCC Concludes that E-Rate Funds Were Erroneously Disbursed, Do the Facts in this Case Warrant a Waiver of the SLD's New Policy?

Spectrum and Riverside complied with all applicable FCC and Program rules when they valued Riverside's trade-in equipment at the time they contracted for services through the E-rate Program (i.e., they did not trade-in equipment that was previously funded through the E-rate Program, and the equipment was traded-in at its fair market value). If, however, the Commission determines that the SLD and USAC correctly determined that the valuation timing utilized by

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[39] Upon receiving the Recovery Letter, Spectrum promptly discussed it with Riverside and informed it that Spectrum would: (i) appeal it to USAC and, if necessary, the FCC; and (ii) invoice Riverside for the shortfall in matching funds in the event Spectrum's appeals are denied. In the event the Commission agrees with USAC's determination that funds were erroneously disbursed, RCOE should immediately be given an opportunity to pay the invoice from Spectrum.

[40] *See Administrator's Decision on Appeal* at 2 (citing *Changes to the Board of Directors of the National Exchange Carrier Association*, FCC 99-291 ¶ 9 (1999)).

[41] F*ederal-State Joint Board on Universal Service*, Order on Reconsideration and Fourth Report and Order, FCC 04-181, CC Docket Nos. 96-45, 97-21, 02-6 at ¶ 1 (rel. July 30, 2004).

[42] *Id.* ¶¶ 13, 15.

Spectrum and Riverside was incorrect based upon a new Program rule and, as a result of this retroactive analysis, Riverside may not have paid the entire non-discounted portion of the services it purchased from Spectrum, then Spectrum requests that the Commission grant a waiver in this case on Riverside's behalf. Riverside should not be forced to pay additional cash consideration for 1999-2000 E-rate services at this time. Had Riverside known that additional cash consideration would be required, it likely would not have contracted for all of the E-rate services it received from Spectrum in the 1999-2000 Program year. As further discussed below, the harm resulting from rescinding the monies allocated to Riverside, or requiring additional cash consideration, far outweighs any purported benefit in denying the waiver, and grant of the waiver is in the public interest.

Pursuant to Section 1.3 of its rules, the FCC may waive one of its rules or procedures when good cause is shown.[43] The U.S. Court of Appeals for the District of Columbia has found that a waiver is appropriate "if special circumstances warrant a deviation from the general rule and such deviation will serve the public interest."[44] Furthermore, there must be a rational policy supporting the grant a waiver.[45] In reviewing a waiver request, the Commission also can weigh "considerations of hardship, equity, or more effective implementation of overall policy."[46] Spectrum's waiver request meets this standard and should therefore be granted.

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[43] 47 C.F.R. § 1.3.

[44] *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164, 1166 n.3 (D.C. Cir. 1990) ("*Northeast Cellular*"); *see also WAIT Radio v. FCC*, 418 F.2d 1153, 1159 n.8 (D.C. Cir. 1969) ("*WAIT Radio*").

[45] *Northeast Cellular*, 897 F.2d at 1166; *WAIT Radio*, 418 F.2d at 1159.

[46] *WAIT Radio*, 418 F.2d at 1159 n.8.

Grant of a waiver in this case will serve the public interest. As previously discussed, there is no way Riverside or Spectrum could have known in 1999 that determining the fair market value for the trade-in equipment at the time of contract formation could be later considered unlawful. The critical public interest policies served by the FCC's and the SLD's rules are to ensure that schools and libraries seeking support through the E-rate Program obtain the most cost-effective services available, thereby lessening applicants' demands on universal service funds and increasing funds available to other applicants.[47] Through Riverside's competitive bidding process, there was fair and open competitive bidding for services, and at the end of the bidding process, Spectrum was found to be most cost-effective choice. As demonstrated above, Riverside did not receive any "free" services from Spectrum, and paid the non-discounted portion of such services with a combination of cash and by trading-in valuable equipment.

The failure to grant a waiver will result in irreparable harm to Riverside. The SLD's Recovery Letter was issued years after the SLD reviewed and approved Riverside's application and Riverside paid monies and traded-in equipment for E-rate services for the 1999-2000 funding year. Services were provided by Spectrum and paid for by Riverside years ago in accordance with all applicable Program rules. Accordingly, if a waiver is not granted, Riverside, who in all likelihood does not have funding in its budget to pay for services rendered years ago, will have to reimburse the monies to SLD. The students and faculty of Riverside will thus be irreparably harmed, which is in direct conflict with the purposes of the E-rate Program.[48]

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[47] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 9029 (1997).

[48] Although the Commission has considered and rejected waiver requests in prior appeals of SLD funding decisions, the facts of this case are clearly distinguishable from those prior decisions. For example, in *MasterMind*, the SLD denied requests for funding that it had yet to allocate to applicants. *See, e.g., Request for Review of Decisions of the Universal Service Administrator by*

The Commission has previously granted waiver requests "in light of the uncertain application of our rules to the novel situation presented."[49] For example, in *Ysleta* the Commission directed the SLD to allow certain applicants to reapply for E-rate discounts, even though the Commission concluded that the applicants violated the E-rate Program's competitive bidding process by using a certain template approach.[50] According to the Commission, a waiver was appropriate in *Ysleta* because the applicants were likely confused by the application of a new rule to the novel facts presented in that case.[51] The Commission should similarly conclude that a waiver is appropriate here because the SLD is applying a new Program rule in this case to rewrite an agreement that was entered into in 1999 in compliance with all known FCC and USAC rules.

IV. RELIEF SOUGHT AND CONCLUSION.

Spectrum requests that the FCC reverse the Administrator's decision denying Spectrum's Appeal and direct the SLD to withdraw the Recovery Letter it issued to Spectrum. If, however, the FCC does not overturn the Administrator's decision, the SLD should seek to recover any funds owed from Riverside. Because the harm in rescinding Riverside's funding would

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MasterMind Internet Services, Inc., 16 FCC Rcd 4028, 4035 (2000). The end result in that case was only that the applicant had to wait another year to apply for and receive funding for services supported by the E-rate Program. In contrast, in the case of Riverside and Spectrum, the SLD has already reviewed, granted and allocated funds pursuant to Riverside's Form 470 and Spectrum has already provided services under that grant. To now reverse the SLD's prior approvals and reclaim amounts already paid would be patently unfair and irreparably harm Spectrum and Riverside.

[49] *Ysleta*, 18 FCC Rcd at 26437.

[50] *Id.* at 26436.

[51] *Id.* at 26437.

outweigh any benefits, Spectrum also requests a waiver of the E-rate Program's rules on Riverside's behalf.

Respectfully submitted,

/s/ Pierre Pendergrass

Pierre Pendergrass
General Counsel
Spectrum Communications Cable
Services, Inc.
226 North Lincoln Avenue
Corona, CA 92882
(909) 273-3114

August 30, 2004

CERTIFICATE OF SERVICE

I, Pierre Pendergrass, certify on this 17th day of August, 2004, a copy of the foregoing Request for Review has been served via first class mail, postage pre-paid, to the following:

Universal Service Administrative Company
Letter of Appeal
Post Office Box 125 – Correspondence Unit
80 S. Jefferson Road
Whippany, NJ 07981

Mr. Elliott Duchon
R O P Riverside County
3939 Thirteenth Street
Riverside, CA 92502

Rina M. Gonzales
Best Best & Krieger LLP
3750 University Avenue
Post Office Box 1028
Riverside, CA 92502-1028

/s/ Pierre Pendergrass

Exhibit 1

Administrator's Decision on Appeal - Funding Year 1999-2000

July 1, 2004

Pierre F. Pendergrass
Spectrum Communications Cabling Services, Inc.
226 North Lincoln Avenue
Corona, CA 92882

Re: R O P Riverside County

Re: Billed Entity Number: 143743
471 Application Number: 148309
Funding Request Number(s): 299355, 299356, 299359, 299361, 299363, 299365, 299367, 299368, 299370, 299371, 299372, 299373, 299376, 299377, 299378, 299379, 299381, 299382

Your Correspondence Dated: December 2, 2003

After thorough review and investigation of all relevant facts, the Schools and Libraries Division ("SLD") of the Universal Service Administrative Company ("USAC") has made its decision concerning your appeal of SLD's Funding Year 1999 Recovery of Erroneously Disbursed Funds (REDF) Decision for the application number indicated above. This letter explains the basis of SLD's decision. The date of this letter begins the 60-day period for appealing this decision to the Federal Communications Commission ("FCC"). If your letter of appeal included more than one application number, please note that for each application an appeal is submitted, a separate letter is sent.

Funding Request Number(s): 299355, 299356, 299359, 299361, 299363, 299365, 299367, 299368, 299370, 299371, 299372, 299373, 299376, 299377, 299378, 299379, 299381, 299382

Decision on Appeal: **Denied in Full**
Explanation:

- You have stated on appeal that the SLD determined that the appropriate valuation date for trade-in equipment is the date the service provider took possession of the equipment but no earlier than the beginning of the funding year, in this case July 1, 1999. You also state that the SLD has relied upon an independent appraisal that Spectrum provided in order to determine the value of the equipment on July 1, 1999. You feel that the SLD

determination in this matter is misguided and SLD should cease its attempt to recover funds disbursed. You close by stating that it is inherently unfair to seek recovery from Spectrum for an incorrect determination of the valuation date because no program rule of FCC guidance on this issue existed at the time the transaction occurred. In fact, the SLD neither announced a rule nor sought guidance from the FCC on this issue until the fist quarter of 2003, four years after the transaction. You add that although the independent appraisal Spectrum provided did value the equipment in the amounts indicated in the REDF Letter, this appraisal is not more authoritative than Spectrum's opinion because Spectrum had first hand knowledge of the actual pieces of equipment in question. Further, the appraisal is less reliable than Spectrum's opinion at the time it received the equipment because the appraisal is based upon information that is almost four years old.

- Upon thorough review of the appeal letter and relevant documentation, we find that the facts support SLD's decision. An Internal Audit found that Spectrum Communications accepted a trade-in amount for the above funding requests. This is permitted under program rules because the original equipment was not purchased with program funds. After the Audit findings, the applicant argued that the calculation of the Fair Market Value (FMV) of the equipment should not be based on a 3-year straight-line depreciation schedule, and SLD accepted this presumption. However, the trade-in amount was based on the value of the equipment at the time of the contract, which was before the start of the funding year and several months before Spectrum was set to take possession of the equipment. Spectrum provided an independent appraisal indicating the FMV of the equipment as of July 1, 1999. SLD has accepted this appraisal and determined that the recovery amounts should be based on the date that Spectrum took possession of the equipment, but no earlier than the first day of the funding year. Although the agreement was executed in March 1999, you have indicated that the equipment was not transferred until after the start of Funding Year 1999. Therefore, it is appropriate for SLD to value the equipment as of July 1, 1999. In its role as program Administrator, USAC must ensure that there is no waste, fraud and abuse. Consequently, the appeal is denied.

- The FCC has directed USAC "to adjust funding commitments made to schools and libraries where disbursement of funds associated with those commitments would result in violations of a federal statute" and to pursue collection of any disbursements that were made in violation of a federal statute. *See In re Changes to the Board of Directors of the National Exchange Carrier Association*, CC Docket Nos. 97-21, 96-45, FCC 99-291 ¶ 7 (rel. October 8, 1999). The FCC stated that federal law requires the Commission to "seek repayment of erroneously disbursed funds" where the disbursements would violate a federal statute. *Id.*. ¶¶ 7, 1. The FCC stated that repayment would be sought "from service providers rather than schools and libraries because, unlike schools and libraries that receive discounted services, service providers actually receive disbursements of funds from the universal service support mechanism." *Id.* ¶ 9.

If you believe there is a basis for further examination of your application, you may file an appeal with the Federal Communications Commission (FCC). You should refer to CC Docket No. 02-6 on the first page of your appeal to the FCC. Your appeal must be received or postmarked within 60 days of the above date on this letter. Failure to meet this requirement will result in automatic dismissal of

your appeal. If you are submitting your appeal via United States Postal Service, send to: FCC, Office of the Secretary, 445 12th Street SW, Washington, DC 20554. Further information and options for filing an appeal directly with the FCC can be found in the "Appeals Procedure" posted in the Reference Area of the SLD web site or by contacting the Client Service Bureau. We strongly recommend that you use the electronic filing options.

We thank you for your continued support, patience, and cooperation during the appeal process.

Schools and Libraries Division
Universal Service Administrative Company

cc: Mr. Elliott Duchon
R O P Riverside County
3939 Thirteenth Street
Riverside, CA 92502

cc: Rina M. Gonzales
Best Best & Krieger LLP
3750 University Avenue
Post Office Box 1028
Riverside, CA 92502-1028

Exhibit 2

SPECTRUM COMMUNICATIONS
CABLING SERVICES, INC.

December 2, 2003

LETTER OF APPEAL

(Sent via email, facsimile and Federal Express)

Letter of Appeal
Schools and Libraries Division
Box 125 - Correspondence Union
80 South Jefferson Road
Whippany, NJ 07981

Re: Recovery of Erroneously Disbursed Funds
Funding Year 1999-2000
Form 471 Application Number: 148309
Applicant Name R O P - Riverside County

Dear Schools and Libraries Division:

Spectrum Communications ("Spectrum") submits this letter to appeal the SLD's Recovery Of Erroneously Disbursed Funds for the following Funding Request Numbers (the "FRNs" or, individually, "FRN"): 299376, 299377, 299378, 299379, 299381, 299382, 299355, 299356, 299359, 299361, 299363, 299365, 299367, 2993368, 299370, 299371, 299372 and 299373.

The Disbursed Funds Recovery Letter is dated October 3, 2003. The named applicant is R O P Riverside County. The Form 471 Application Number is 148309. The Billed Entity Number is 143743.

Provided below is the contact information for the person authorized to discuss this appeal on behalf of Spectrum:

Pierre F. Pendergrass
General Counsel
Spectrum Communications
226 N. Lincoln Avenue
Corona, CA 92882
Tel.: 909-371-0549
Fax: 909-273-3114
Email: Pierre@Spectrumccsi.com

226 NORTH LINCOLN AVENUE • CORONA, CA 92882
(909) 371-0549 • (800) 319-8711 • FAX (909) 273-3114

I. PRELIMINARY STATEMENT

Spectrum, a privately held corporation founded in 1985, is a provider of information technology products and services. The company's customer base is primarily the education market, public sector agencies and large healthcare facilities. The company has participated in the E-Rate program since 1998. Since then, Spectrum has acted as a service provider for approximately 38 different school districts.

R O P - Riverside County, also known as the Riverside County Office of Education ("RCOE"), is a service agency supporting Riverside County's 23 school districts and linking them with the California Department of Education. RCOE provides, among other services, assistance to its member districts in the deployment and maintenance of network and telecommunications services. There are approximately 6.1 million students enrolled throughout Riverside County for the 2002-03 school year.

For E-Rate Funding Year 1999-2000, RCOE formed a consortium of its member school districts for the purpose of applying for E-Rate discounts. On March 5, 1999, RCOE filed a Form 470 (Number 220100000227898) soliciting proposals from prospective service providers for a range of E-Rate eligible products and services. After examining existing equipment which RCOE consortium members intended to trade-in to Spectrum for the purpose of providing its E-Rate matching funds, Spectrum determined the fair market value of the equipment to be $1,813,505.83. Spectrum then submitted a bid proposal in response to the Form 470 and RCOE subsequently selected Spectrum as the service provider for the consortium. On April 5, 1999, RCOE filed a Form 471 (number 148309) evincing its acceptance of Spectrum's proposal and its selection of Spectrum as its service provider for Funding Year 1999-2000.

The total pre-discount value of the agreement between RCOE and Spectrum was $5,495,472.20. RCOE was eligible for an E-Rate discount of sixty-seven percent (67%). Consequently, RCOE and/or its consortium members were required to provide matching funds at a rate of 33% or $1,813,505.83 total. In or around March, 1999, when RCOE and Spectrum entered into the agreement for E-Rate services, the parties agreed that Spectrum would accept, in lieu of cash, the consortium equipment Spectrum had valued at $1,813,505.83 as RCOE's payment for the non-discounted portion of the contract price.

The SLD now contests the value of the trade-in equipment RCOE provided as its matching component. More precisely, the SLD contends that the appropriate trade-in value of the equipment was its fair market value at the beginning of the funding year (July 1, 1999) and not its fair market value on the date RCOE and Spectrum entered into the agreement for services (March 1999). The SLD contends that the total fair market value of the consortium's equipment on July 1, 1999 was $1,316,159. Consequently, the SLD seeks recovery in the amount of $707,521.34.

II. THE DISBURSED FUNDS RECOVERY LETTER

The Disbursed Funds Recovery Letter, dated October 3, 2003, is a total of 22 pages. Pages 1 through 4 describe the process for filing an appeal and also provide a guide to the funding disbursement synopsis. Pages 5 through 22 each seek recovery for a specific FRN. For each of the 18 FRNs in question, the basis of recovery is the contention that on July 1, 1999, the fair market value of the trade-in equipment was less than the non-discounted share that the applicant was required to pay. Specifically, for each of the FRNs, the Disbursed Funds Recovery Letter states the following:

> "The valuation of the trade-in equipment must be based on the fair market value of the equipment. Furthermore, the valuation date should be the date

> the service provider took possession of the equipment, but not earlier than the beginning of the funding year."

Spectrum appeals the determination by the SLD that the valuation date should be the date the service provider took possession of the equipment, but no earlier than the beginning of the funding year.

Pages 5 through 22 of the Disbursed Funds Recovery Letter reach a determination of the value of the trade-in equipment on July 1, 1999 for each of the FRNs. Specifically, for each of the FRNs, pages 5 through 22 state the following:

> "The service provider has provided an independent appraisal of the trade-in equipment. Using the July 1, 1999 value indicated in that appraisal, it was determined that the trade-in value was only (*amount varies by FRN*), which is (*amount varies by FRN*) less than the non-discounted share of (*amount varies by FRN*) that the applicant was obligated to pay."

Spectrum appeals the determination by the SLD that the actual fair market value of the equipment on July 1, 1999 was the value indicated in the independent appraisal.

III. ARGUMENT

The SLD has determined that the appropriate valuation date for trade-in equipment is the date the service provider took possession of the equipment but no earlier than the beginning of the funding year or, in this case, July 1, 1999. Further, the SLD has relied upon an independent appraisal Spectrum provided in order to determine the value of the equipment on July 1, 1999. These determinations are misguided and the SLD should cease its attempt to recover funds disbursed pursuant to the FRNs.

Firstly, any agreement that contemplates an equipment trade-in in lieu of cash must assign a value to the equipment at the time of contract formation - not at a later date. Otherwise, the applicant will not know its payment obligations under the agreement. Furthermore, for

Funding Year 1999-2000, the SLD required an applicant to enter an agreement and file a Form 471 by April 6, 1999. As a result, it was impossible for RCOE and Spectrum to value the equipment at the start of the funding year (July 1, 1999) and still comply with the SLD's requirement that the agreement be formed and the Form 471 be filed by April 6, 1999.

Secondly, it is inherently unfair to seek recovery from Spectrum for an incorrect determination of the valuation date because no program rule or FCC guidance on this issue existed at the time the transaction occurred. In fact, the SLD neither announced a rule nor sought guidance from the FCC on this issue until the first quarter of 2003 - four years after the transaction.

Thirdly, although the independent appraisal Spectrum provided did value the equipment in the amounts indicated in the Disbursed Funds Recovery Letter, this appraisal is not more authoritative than Spectrum's opinion because Spectrum had first-hand knowledge of the actual pieces of equipment in question. Further, the appraisal is less reliable than Spectrum's opinion at the time it received the equipment because the appraisal is based upon information that is almost four years old.

Lastly, if funds were, in fact, erroneously disbursed as a result of the use of an incorrect valuation date, the appropriate remedy is to require RCOE to pay Spectrum the corresponding non-discounted portion because this is what would have been required at the time of transaction had the parties known the correct valuation date. Alternatively, the SLD should seek full recovery from the applicant alone because recovery from Spectrum will result in RCOE having paid less than its required matching portion - a clear rule violation and an abuse of the E-Rate Discount Mechanism.

A. THE APPROPRIATE VALUATION DATE IS THE DATE THE PARTIES ENTERED INTO AN AGREEMENT FOR SERVICES - NOT THE DATE THE SERVICE PROVIDER TOOK POSSESSION OF THE EQUIPMENT OR, IN THIS CASE, JULY 1, 1999.

The E-Rate program rules require the service provider and the applicant to enter into an agreement before the Form 471 is filed. This agreement necessarily establishes the type and amount of consideration to be paid for the goods and services purchased. Consequently, any agreement that contemplates the trade-in of equipment in lieu of a cash payment must assign a value to the equipment at the time of contract formation - not at a later date. Otherwise, the parties will have no way of determining the actual price in the contract and the validity of the contract would be in doubt. For this reason alone, the appropriate valuation date could not be July 1, 1999 or, alternatively, the date Spectrum took possession of the equipment.

Furthermore, the SLD's Funding Year 1999-2000 requirement that the applicant enter an agreement with the service provider and file Form 471 by April 6, 1999 made it impossible for RCOE and Spectrum to value the equipment at the start of the funding year (July 1, 1999) and still comply with the requirement that the agreement be formed and the Form 471 be filed by April 6, 1999. The agreement between RCOE and Spectrum necessarily defined the type and amount of consideration RCOE was required to pay and, therefore, had to assign a value to the trade-in equipment. If the parties had waited until the start of the funding year (July 1) to value the equipment, RCOE would have missed the deadline for filing its Form 471.

After carefully considering the type, amount and condition of the equipment held by the RCOE consortium, Spectrum developed a proposal that would enable the consortium members to meet their technology plan objectives while, at the same time, avoid a cash outlay. RCOE reviewed this proposal and found it to be the most cost-effective response to its Form 470. However, before agreeing to hire Spectrum, RCOE and/or its consortium members were required

to obtain board approval of the proposed contract with Spectrum. It would have been impossible for RCOE and its member districts to have obtained board approval without first describing in detail the purchase price and the terms (including the amount of cash required) of the agreement. Consequently, the parties had to value the equipment at the time they reached an agreement.

B. IT IS UNFAIR TO SEEK RECOVERY FOR THIS MATTER BECAUSE NO RULE OR *GUIDANCE REGARDING* TRADE-IN VALUATIONS EXISTED EITHER AT THE TIME THE PARTIES ENTERED INTO THE AGREEMENT OR ON JULY 1, 1999.

It is inherently unfair to seek recovery from Spectrum for an incorrect determination of the valuation date because no program rule or FCC guidance on this issue existed at the time the transaction occurred. As evidenced by a March 3, 2003 email from Ed Falkowitz of the SLD to John Price, CFO of Spectrum, neither Spectrum nor the SLD learned of any guidance on this issue until ***four*** years after RCOE and Spectrum reached their agreement. At the time RCOE and Spectrum reached their agreement most of the rules or guidance surrounding trade-in equipment addressed the issues of the original source of funds for the equipment and its fair market value in general. Specifically, the rules required equipment to be traded in at its fair market value and prohibited a trade-in of equipment that was purchased with E-Rate funds. The rules were silent, however, on which date the fair market value should be assessed.

The guidance provided in the March 3, 2003 email from Ed Falkowitz announces a new policy of which neither RCOE, Spectrum, nor the SLD were aware. If the entity charged with administering the program and preventing waste, fraud and abuse did not anticipate the need for guidance on this issue when it contemplated allowing trade-ins, it is certainly unfair to expect the applicant and the service provider to have done so. Between the SLD, RCOE and Spectrum, the SLD should bear the risk of the consequences of a new policy since it has the exclusive responsibility of administering the program.

Moreover, it is unfair for a program participant, exercising good faith and complying with all applicable rules, to be penalized for acting reasonably under the circumstances. However, Spectrum will be penalized for acting reasonably if this appeal is not granted. For the reasons discussed above, it would have been entirely unreasonable to assume the valuation date to be any date other than the date the parties reached an agreement. This is particularly true in the absence, as here, of an SLD rule or FCC guidance on which date is the appropriate for equipment valuations. Consequently, RCOE and Spectrum had no other recourse but to reasonably assume the equipment should be valued at the time the agreement is formed.

Lastly, USAC's role of preventing waste, fraud and abuse in the program is severely undermined if program participants are penalized for acting reasonably in the absence of a clear rule or guidance on an issue. USAC should encourage participants to act reasonably and in good faith whenever the rules are silent on a particular issue. To do otherwise is to encourage waste, fraud and abuse.

C. THE ACTUAL FAIR MARKET VALUE OF THE TRADE-IN EQUIPMENT ON JULY 1, 1999, WAS NOT THE AMOUNT INDICATED IN THE APPRAISAL, BUT RATHER THE AMOUNT SPECTRUM ACTUALLY DETERMINED IT TO BE.

The appraisal which values the equipment at $1,316,159 as of July 1, 1999, is not more authoritative than Spectrum's opinion of the value. Unlike the appraiser who compiled the report, Spectrum (i) had actually sold and installed the specific pieces of equipment at issue, (ii) was knowledgeable about the manner in which the equipment had been used and maintained, (iii) was knowledgeable about the training and expertise of the staff who had been using the equipment, and (iv) most importantly, knowledgeable about the identity and needs of potential buyers of the specific pieces of equipment in question. As a result of this additional knowledge which the appraiser lacked, Spectrum's opinion on the value of the equipment at issue is

inherently more reliable than an appraiser's opinion formed four years after Spectrum's opinion. Each of the aforementioned facts within Spectrum's knowledge caused Spectrum to value the equipment more highly than a party without these facts might. For these reasons, USAC should defer to Spectrum's assessment of the equipment's value.

D. IF FUNDS WERE ERRONEOUSLY DISBURSED, THE APPROPRIATE REMEDY IS AN INCREASE IN THE NON-DISCOUNTED PORTION THE APPLICANT IS REQUIRED TO PAY OR, ALTERNATIVELY, FULL RECOVERY FROM THE APPLICANT OF THE ERRONEOUSLY DISBURSED AMOUNT.

If funds were, in fact, erroneously disbursed as a result of the use of an incorrect valuation date, the appropriate remedy is to require the applicant to pay Spectrum the corresponding non-discounted portion because this is what would have been required at the time of the transaction had the parties known the appropriate valuation date. Given the absence of bad faith by both RCOE and Spectrum, no purpose is served by imposing the harsh penalty of a full recovery against Spectrum. Instead, the SLD should seek to obtain the result that would have occurred had a clear rule defining the appropriate valuation date been in place at the time the parties reached their agreement. Therefore, the SLD should require RCOE to pay Spectrum matching funds that are appropriate for the amount of E-Rate funds actually disbursed.

Furthermore, Spectrum did not receive USAC's final determination of the amount that RCOE failed to pay for the non-discounted services until Spectrum received the Disbursed Funds Recovery Letter dated October 3, 2003. Spectrum has sent RCOE the attached invoice for the remaining matching funds. In the event USAC determines funds were erroneously disbursed, RCOE should immediately be given an opportunity to pay the invoice from Spectrum.

Alternatively, if USAC denies RCOE the opportunity to pay for the remaining non-discounted services, USAC should seek the entire recovery from RCOE because recovery from

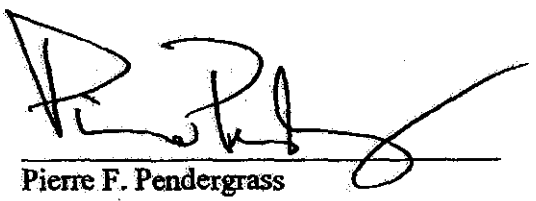
Spectrum will result in RCOE having paid less than its required matching portion - a clear rule violation and an abuse of the E-Rate program. RCOE received all of the services for which it contracted. Consequently, it should pay the full contract price, less any E-Rate discounts to which it is actually entitled. If the SLD recovers disbursed funds from Spectrum, Spectrum will have provided all of the services it was obligated to provide, but Spectrum will receive only a portion of the price it legally and reasonably charged for those services. This unreasonable and unfair result will undermine the integrity of the program.

IV. CONCLUSION

Based on the foregoing, USAC should immediately reverse its determination that E-Rate funds were erroneously disbursed to RCOE for funding year 1999-2000.

Respectfully submitted,

SPECTRUM COMMUNICATIONS CABLING SERVICES, INC. D/B/A/ SPECTRUM COMMUNICATIONS

By: 

Pierre F. Pendergrass

Its: General Counsel

Date: December 2, 2003

Attachments (3)
SLD website announcement regarding deadline for Form 471 for funding year 1999-2000
Email from Ed Falkowitz dated March 17, 2003
Invoice from Spectrum to RCOE dated December 2, 2003

Graphics Off

February 1999 Announcements

Please click on the topic below to view the most recent announcements:

- **Wave 10 is the End! Final Wave of Funding Commitments Available** (2/27/1999)
- **New Search Function! Service Provider Information by SPIN** (2/24/1999)
- **Wave 9 Recipients of E-rate Funding** (2/20/1999)
- **Form 471 Minimum Processing Standards** (2/20/1999)
- **10 BEAR Form Tips** (2/12/1999)
- **Fact Sheet on Library Consortia** (2/10/1999)
- **New!! Type-In / Print-Out Your Form 486** (2/5/1999)
- **Application Window Extended to April 6, 1999** (2/3/1999)
- **Wave 7 Recipients of E-rate Funding** (2/3/1999)
- **More Waves to Come!** (2/3/1999)
- What's New Archives...

Apply Online
- Reference Are
- Appeals
- Eligible Servic List
- Changes & Corrections
- Suspensions & Debarments
- Waste, Fraud, Abuse Task Force

Search Tips

Submit a Question
- Contact Us
- Whistleblower Hotline - Repo Waste, Fraud, Abuse

- Site Map
- Site Tour
- Website Policy

Wave 10 is the End! Final Wave of Funding Commitments Available (2/27/1999)

Top of Page

The Schools and Libraries Division has issued its final wave of funding commitment decisions for the 1998 program year. This final wave means:

- Funding commitment decision letters will go to the 6% of in-the-window applicants who had not yet received a decision from us. Information about these funding commitments is now posted on this Web Site (www.sl.universalservice.org/reference/fndcommit.asp), and applicants should receive their letters during the following week.

- Letters will also go out to those applicants whose internal connections requests were deemed "as yet unfunded" until this wave. Approved internal connections requests at the 70% discount level and above will be funded; we will NOT have funds to accommodate internal connections requests at or below 69% discount.

- We now know definitively that we will NOT be able to consider for funding any applications received outside the 75-day window. These applicants will be notified

soon of our regrets in this regard.

- Special note: If you filed a 1998 application but have not had ANY response from SLD through this final Wave 10, watch the Web Site for instructions on how to proceed with an inquiry about your application.

Congratulations to the tens of thousands of trailblazing schools, libraries, and consortia who are now celebrating their well-deserved Year One E-rate successes. We know you will inspire your colleagues who have not yet been reached by the E-rate, and we look forward to serving both veterans and newcomers in Year Two. But both must act quickly: the deadline for all Year Two applications is fast approaching. We strongly recommend that you file your Form 470 so that it is posted on the SLD Web Site no later than March 5, 1999. Keep the E-rate flowing for your school or library - file Form 470 today!

New Search Function! Service Provider Information by SPIN (2/24/1999) Top of Page

The SLD has added a new search function to the Provider Area. This "Service Provider Information by SPIN" search provides service providers with important information regarding the "post-commitment" phase of the funding process, including:

- Status of the certification of service provider's SPIN
- Percentage of FRNs for which this company received a FCDL per Wave
- Dates Form 486 Notification letters sent to service provider's SPIN
- Dates BEAR (Billed Entity Applicant Reimbursement) letters sent to service provider's SPIN

Wave 9 Recipients of E-rate Funding (2/20/1999) Top of Page

Click here to download state reports on the Funding Commitment Decisions in Wave Nine, the largest wave of letters released to date. This Wave consists of approximately 3700 funding commitment decisions letters totaling $323 million in E-rate funds. The Wave Nine release pushes the total dollars committed to over $1.4 billion, covers 94% of applicants who filed within the E-rate application window, and, for the first time, extends funding to cover internal connections requests for applicants who qualify for a discount level as low as 70%.

Form 471 Minimum Processing Standards Top of Page

Form 471 Minimum Processing Standards Top of Page
(2/20/1999)

Minimum Processing Standards are the procedures that the SLD uses to review your application when we first receive it. Your application must pass the Minimum Processing Standards in order for us to begin entering your application into our data system. Click here for Minimum Processing Standards.

10 BEAR Form Tips (2/12/1999) Top of Page

If you are among the thousands of E-rate applicants receiving a funding commitment decisions letter in Wave 8 (in the mail now) or Wave 9 (scheduled for next week), you may be preparing to file a Billed Entity Applicant Reimbursement (BEAR) Form for the first time. Officially known as FCC Form 472, the BEAR Form is the tool you use to request reimbursement for E-rate discounts on approved services you've already paid for. The BEAR Form comes with your funding commitment letter; it's also available on the Schools and Libraries Division Web Site (www.sl.universalservice.org) as a downloadable PDF file and as a type-in/print out form.

Click here to read some reminders about how the BEAR process works-and some tips to make it work well for you.

Fact Sheet on Library Consortia (2/10/1999) Top of Page

The Form 470 Guidance Section in the Reference Area now features a Fact Sheet on Library Consortia.

New!! Type-In / Print-Out Your Form 486 Top of Page
(2/5/1999)

The SLD has created a new application tool: a version of the Form 486 that you can download from this Web Site, fill in on your computer, print out, and mail to us. This Form 486 is virtually identical to the PDF (Portable Document Format) file that has been available on our Web Site, but now you can enter information directly into the form rather than just printing out a blank hard copy and then filling out the form by hand.

Type-In/Print Out Form 486

Please note: This form does **NOT** electronically transmit data to the SLD, but instead makes your completion of the paper form easier and neater.

You must have Adobe's free Acrobat Reader 3.01 installed on your computer in order to access the Form 486. Click here for information on obtaining this software, as well as specific instructions for downloading the Form 486 from this Web

having to worry about rushing your Form 471 application and attachments into overnight mail on Monday, April 5.

For help filing your Form 470 in a timely fashion, please see "Top 10 Reasons You Should File Your Year 2 E-Rate Application NOW" (at www.sl.universalservice.org or via fax-on-demand, 800-959-0733, document #206) and the forthcoming "Quick Tips for Filing Your Form 470 - Even If You Don't Have a 1998 Funding Letter Yet."

Wave 7 Recipients of E-rate Funding (2/3/1999) Top of Page

Click here to download state reports on the Funding Commitment Decisions in Wave Seven. This Wave consists of 1,500 funding commitment decisions letters totaling $140 million in E-rate funds. The average commitment in this wave is over $93,300 per applicant.

More Waves to Come! (2/3/1999) Top of Page

With the Wave 7 commitments plus the number of applicants notified that their requests could not be funded (due to ineligible services or internal connections below the discount threshold), SLD has responded to more than two-thirds of its 1998 in-the-window applicants. Approximately $760 million has been committed through Wave Seven, or about 40% of the available funding.

Wave Seven is NOT the last wave of E-rate funding commitments for the year. It will be followed by two to four additional waves before the process is concluded. While we had hoped to make the vast majority of commitments by the end of January, and worked diligently to do so, we are also committed to providing detailed review of each application for compliance with program rules, as we agreed to do in the course of our audits by both the General Accounting Office and PricewaterhouseCoopers. We are completing our final review of each application as quickly as we can without sacrificing assurance of program integrity, and have continued to add staff resources to expedite the overall review process.

Please watch the SLD Web Site (www.sl.universalservice.org) and our Newsflash distribution for more information about the schedule of upcoming funding commitments. We are also encouraging all current and potential E-rate applicants to get their 1999-2000 Form 470 in as soon as possible to begin the E-rate process for Year 2.

Content Last Modified: June 24, 2003

Need help? You can contact us toll free at 1-888-203-8100.
Our hours of operation are 8AM to 8PM, Eastern Time, Monday through Friday.
Aware of fraud, waste, and abuse, report it to our Whistleblower Hotline!

INVOICE

SPECTRUM COMMUNICATIONS
Cabling Services, Inc.
226 N. Lincoln Avenue
Corona, CA 92882-1893
(909) 371-0549

INVOICE NO. 5182003

INVOICE DATE: 12/02/2003

SIR NO. 0000639

Sold To:
Riverside Co. Office of Education
Attn. Tony Johnson
3939 Thirteenth Street
Riverside, CA 92502

Ship To:

Purchase Order No.	CSR #	Ship/Install Date	Via/Type	Terms
N/A	N/A	1999-2000	Bid	NET 30

Quantity	Description	Amount
	Persuant to USAC's October 3, 2003 request for recovery of erroneously disbursed E-Rate funds related to equipment trade-in values for E Rate funding year 1999-2000, we are submitting the enclosed invoice to RCOE for the non-discounted services USAC has alleged are unpaid. See attachment for detail.	

Equipment title transfer upon receipt of full payment.

All Invoices that are past due are subject to finance charges at the rate of 1.5% per month.

Federal Tax Identification No. 33-0662939

California State Contractors License No. 713766
(C-7 Low Voltage)

Oregon State Contractors License No. 93577
(Specialty Contractor)

Small Business Administration Certifications No. 0006245

Spectrum Communications is an
"EQUAL OPPORTUNITY EMPLOYER"

Parts	
Labor	
Total	
Tax	
Freight	
Discount	
Balance Due	$348,480.97

RCOE
Exhibit G
Page 52 of 76

ppendix III
nalysis of Trade In received by Spectrum
iverside County (BEN 143743)
EN 143743, Form 471 #148309

RN#	Amount Paid	Amount Approved	School	Discount	Non-Discounted Portion	Quanity Traded-In 5000	Other	Trade-In Value	Paid In Cash	July Valuation Total Payments by Applicant	Maximum Commitment Amount	Refund Due	Customer Match Required
299371	$190,018.55	$190,018.55	Alvord	67	$93,591.23	2	27	$ 73,871.92		$ 73,871.92	$ 149,982.39	$ 40,036.16	19,719.30
299376	$103,272.47	$103,272.47	Banning	67	$50,865.54	1	15	$ 38,966.30		$ 38,966.30	$ 79,113.39	$ 24,159.08	11,899.25
299375	$92,254.87	$92,254.87	Beaumount	67	$45,438.97			$ -	$ 45,438.69	$ 45,438.69	$ 92,254.31	$ 0.56	0.28
299374	$174,886.16	$174,886.16	Coachella	67	$86,137.96			$ -	$ 86,137.92	$ 86,137.92	$ 174,886.08	$ 0.08	0.04
299356	$335,966.71	$335,966.71	Corona Norco	67	$165,476.14	4	46	$ 136,915.37		$ 136,915.37	$ 277,979.70	$ 57,987.01	28,560.77
299369	$16,526.39	$16,526.39	Desert Center	67	$8,139.86			$ -	$ 8,139.87	$ 8,139.87	$ 16,526.40	$ -	0.01
299370	$313,931.52	$313,931.52	Desert Sands	67	$154,622.99	4	42	$ 131,501.14		$ 131,501.14	$ 266,987.16	$ 46,944.36	23,121.85
299365	$212,053.73	$212,053.73	Hemet	67	$104,444.37	2	31	$ 79,286.16		$ 79,286.16	$ 160,974.92	$ 51,078.81	25,158.22
299372	$217,562.53	$217,562.53	Jurupa	67	$107,157.66	2	32	$ 80,639.72		$ 80,639.72	$ 163,723.06	$ 53,839.47	26,517.95
299373	$184,509.75	$184,509.75	Lake Elsinore	67	$90,877.94	2	26	$ 72,518.36		$ 72,518.36	$ 147,234.25	$ 37,275.50	18,359.57
299367	$44,070.38	$44,070.38	Menifee	67	$21,706.31	0	8	$ 10,828.47		$ 10,828.47	$ 21,985.08	$ 22,085.30	10,877.84
299382	$395,168.80	$395,168.80	Moreno Valley	67	$194,635.38	5	53	$ 165,053.20		$ 165,053.20	$ 335,108.01	$ 60,060.79	29,582.18
299381	$125,307.65	$125,307.65	Murrieta	67	$61,718.69	1	19	$ 44,380.53		$ 44,380.53	$ 90,105.93	$ 35,201.72	17,338.16
299354	$33,052.78	$33,052.78	Nuview	67	$16,279.73			$ -	$ 16,279.73	$ 16,279.73	$ 33,052.79	$ -	0.00
299355	$173,492.15	$173,492.15	Palm Springs	67	$85,451.36	2	24	$ 69,811.25		$ 69,811.25	$ 141,737.98	$ 31,754.17	15,640.11
299363	$86,746.08	$86,746.08	Palo Verde	67	$42,725.68	1	12	$ 34,905.62		$ 34,905.62	$ 70,868.99	$ 15,877.09	7,820.06
299378	$44,070.38	$44,070.38	Perris Elementary	67	$21,706.31	0	8	$ 10,828.47		$ 10,828.47	$ 21,985.08	$ 22,085.30	10,877.84
299377	$86,746.08	$86,746.08	Perris High	67	$42,725.68	1	12	$ 34,905.62		$ 34,905.62	$ 70,868.99	$ 15,877.09	7,820.06
299353	$246,431.28	$246,431.28	Riverside USD	67	$121,376.60	5	26	$ 128,507.11		$ 128,507.11	$ 260,908.38	$ -	0.00
299368	$38,561.58	$38,561.58	Romoland	67	$18,993.02	0	7	$ 9,474.91		$ 9,474.91	$ 19,236.94	$ 19,324.64	9,518.11
299359	$75,728.49	$75,728.49	San Jancinto	67	$37,299.11	1	10	$ 32,198.50		$ 32,198.50	$ 65,372.72	$ 10,355.77	5,100.60
299379	$179,000.95	$179,000.95	Temecula	67	$88,164.65	2	25	$ 71,164.80		$ 71,164.80	$ 144,486.12	$ 34,514.83	16,999.84
299361	$312,606.76	$312,606.76	Val Verde	67	$153,970.49	1	53	$ 90,401.53		$ 90,401.53	$ 183,542.51	$ 129,064.25	63,568.96
		$3,881,966.04			$1,813,505.66	36	478	$1,316,159.00	$155,996.21	$1,472,155.21	$2,988,921.16	$ 707,521.97	348,460.97

Exhibit 3

SPECTRUM COMMUNICATIONS
CABLING SERVICES, INC.

Date: March 15, 2003

To: Ed Falkowitz
Schools and Libraries Division

From: Robert Rivera

Subject: Riverside (Ben 143743) FY 1999- Equipment Trade-In

Attached is the Appraisal report for the equipment received as trade in for the balance due from customers within the Riverside consortium. We have had the equipment appraised as of March 1, 1999 which is the month the agreement between the Riverside consortium and Spectrum Communications was negotiated and the Form 471 submitted to the SLD. In addition, as you requested we had the equipment appraised as of July 1, 1999. Using these appraisals, below is a summary table of the results of the transaction:

	March 1, 1999	July 1, 1999
Equipment Appraised Value (per report)	$1,859,321	$1,316,159
Cash Received	155,996	155,996
Total	$2,015,317	$1,472,155
Customer Match	1,813,506	1,813,506
Difference	$ 201,811	$ (341,351)

As shown above, at the time Spectrum Communications entered into the transaction the value of the equipment was well above the customer match required for E-rate discounts. Given the program rules and guidelines available at the time the transaction was agreed upon, we believe using the contract date for valuation was a prudent and reasonable basis for establishing value when consummating this transaction.

If you have any questions, please call me.

Robert Rivera
Spectrum Communications
(909) 371-0549

Appraisal Report

For

Spectrum Communications

By

DMC Consulting Group
Newport Beach, CA

March 2003

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List of Figures

Appraisal Report

DMC Consulting Group (DMC) presents the following summary desktop appraisal as an *opinion of value* of high-tech Cisco network communications equipment sold to Riverside County in March 1999. The following is a list of the documents submitted to DMC for review by Spectrum Communications.

- Summarized equipment spreadsheet for the Cisco Equipment

The portfolio was appraised for End-User Fair Market Value for March 1999 and July 1999. The listing of the equipment and the forecast appear as Exhibit B and the end of this appraisal report.

Overview of Report

This appraisal report identifies the assets in question and determines the various Fair Market Values for March 1999 and July 1999. Adherence to the code of ethics and the requirement and standards of Uniform Standards of Professional Appraisal Practices and the conduct of an appraiser as a member of the American Society of Appraisers is strictly followed for the creation of this report.

Purpose and Use of the Appraisal

The purpose of this appraisal is to provide an *independent valuation opinion* with regard to the Fair Market Values at the two dates mentioned. This was done through the use of researching the equipment, using reports available in the marketplace and applying my 17 years of valuing computer equipment to arrive at the *opinion of value* presented. This report should be used as an *opinion of value* as of the appraisal dates for the assets listed.

The End-User value is the price the user would pay to a vendor, computer broker or lessor for the equipment in an arms length contract subject to the definition of Fair Market Value (FMV) listed later in this report. Cisco does not charge the end-user for freight and installation of this type of equipment. The End-User valuation represents on average what the user can expect to pay for like equipment in the specific timeframe requested.

Objective and Valuation Date of Appraisal

The objective is to give an opinion of Fair Market Value as of March 1999 and July 1999 for the equipment in the detail listing in Exhibit B.

Definition and Premise of Value

"Fair Market Value - Installed" (FMV) is defined as the price that the equipment should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition are the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated;
2. both parties are well informed or well advised, and acting in what they consider their best interests;
3. a reasonable time is allowed for exposure in the open market;
4. payment is made in terms of cash in United States dollars or financial arrangements comparable thereto; and
5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale."

For purposes of this valuation freight and installation are not included in the value of the equipment.

Description of Subject Computer Assets

The subject computer assets are listed in Exhibit B. *Portfolio Analysis - Detail.*

There was no inspection of the assets listed. It is assumed that:

- *The equipment was under a normal maintenance agreement from the manufacturer since it was first installed.*
- *The equipment was up to its current engineering level.*
- *The equipment was in a proper room environment and subject only to the normal wear and tear of such use.*
- *The equipment was used for normal business applications.*

Approaches to Value

The generally accepted approaches to tangible personal property valuation include the income approach, cost approach and the market approach. The following outlines these various approaches to value.

Income Approach

The income approach considers value in relation to the present worth of anticipated future benefits derived from ownership and is usually measured through the capitalization of a specific

level of income, (i.e. net income or net cash flow). The net income or net cash flow is projected over an appropriate period and is then capitalized at an appropriate capitalization or discount rate.

While the cost approach and the market approach are readily applicable in many situations of computer equipment valuations, the income approach is less frequently applied since it is usually difficult to isolate a unique income stream.

Cost Approach

The cost approach is that approach which measures value by determining the current cost of an asset and deducting for the various elements of depreciation, physical deterioration and functional and economic obsolescence. This approach is based on the proposition that the informed purchaser would pay no more for computer equipment than the cost of producing substitute equipment with the same utility as the subject asset from the same manufacturer.

The main definitions of cost are reproduction cost and replacement cost. Reproduction cost considers the construction of an exact replica of the asset. Replacement cost considers the cost to recreate the functionality or utility of the subject asset.

The cost approach commonly measures value by estimating the current cost of a new asset, and then deducts value for various elements of depreciation, including physical deterioration and functional and external obsolescence to arrive at "depreciated cost new". This "cost" may be either reproduction or replacement cost. The logic behind this method is that an indication of value of the asset is its cost (reproduction or replacement) less a charge against various forms of obsolescence such as functional, technological and economic as well as physical deterioration if any.

Thus:	Current Cost of Replacement or Reproduction New
Less:	Physical Deterioration
Less:	Functional Obsolescence
Less:	External Obsolescence
Results in:	**Fair Market Value**

The availability and cost of the substitute asset is directly affected by shifts in the supply and demand of the utility. Utility may be measured in many ways including functionality, desirability, etc. Costs typically include the cost of all material, labor, overhead, and entrepreneurial profit (or return on the investment in the subject tangible personal property).

Market Approach

The logic behind the market approach for computer equipment is that a prudent investor can go to the marketplace and purchase an exact copy of the asset with the same features and/or